

**DEPARTMENT OF WATER RESOURCES**

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MAR 13 2009

TO: Distribution List

Assembly Bill 1X (Chapter 4, Statutes of 2001), among other things, established Section 27 of the California Water Code, authorized the Department of Water Resources (DWR) to enter into long-term contracts with power suppliers, authorized DWR to issue revenue bonds and required DWR to make quarterly and annual reports to the Governor and the Legislature regarding California Energy Resources Scheduling Divisions' activities. The March 31, 2008 report, attached, is the first to be issued since the sunset of legislation halting the issuance of such reports for calendar years 2004 through 2007. The report includes historical information to add context and also contains updated detail of events since the last report.

If you have any questions, please contact me at (916) 653-7007 or your staff may contact Russell Mills, Chief of Financial Management, at (916) 574-2756.

Sincerely,

A handwritten signature in dark ink, appearing to read "Lester A. Snow", followed by a long horizontal line.

Lester A. Snow  
Director

Attachments

Mr. Gregory P. Schmidt  
Secretary of the Senate  
State Capitol, Room 3044  
Sacramento, California 95814

Mr. E. Dotson Wilson  
Chief Clerk of the Assembly  
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Department of Water Resources

# **California Energy Resources Scheduling**

**A Division of  
California Department of Water Resources**

**Activities and Expenditures Report  
Quarter Ended March 31, 2008**

**(Provides Data as Required by Section 80250 of the California Water Code )**



# Activities and Expenditures Report

## For The Quarter Ended March 31, 2008

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# Preface

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This report is issued pursuant to the reporting requirement in Section 80250 of the California Water Code, and includes background information about the California Energy Resources Scheduling Division (CERS) of the Department of Water Resources as well as summary information on CERS activities and expenditures quarter ended March 31, 2008.

CERS purchases power under the terms of its existing contracts, all of which were entered into prior to January 1, 2003. The scheduling, dispatch and certain other administrative functions for the contracts are managed by the investor owned utilities (IOUs). CERS continues to have financial and legal responsibility for its contract portfolio and oversees repayment of the revenue bonds.

The audited financial statements for the years ended June 30, 2007 and 2006, and the unaudited financial statements for the quarter ended March 31, 2008, prepared in accordance with generally accepted accounting principles, can be referenced at the following link: [http://www.cers.water.ca.gov/financial\\_bonds.cfm](http://www.cers.water.ca.gov/financial_bonds.cfm).

This report is available on the DWR website at [www.cers.water.ca.gov](http://www.cers.water.ca.gov).



# CERS History

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## **Winter 2000-2001**

Spot market prices skyrocketed to \$2,000 a megawatt hour while averaging about \$400 per MWh – nearly 10 times the cost of power at the same time in the previous year.

Debt grew for California's IOUs, specifically PG&E, SCE, and SDG&E, as purchased power costs exceeded what they were able to recoup from ratepayers. Suppliers refused to sell to IOUs because of credit concerns.

Large numbers of generators were off-line resulting in statewide rotating blackouts.

## **Governor Issued Emergency Proclamation**

On January 17, 2001, the Governor issued an Emergency Proclamation directing the Department of Water Resources (DWR) to purchase power on behalf of the State's IOU customers.

DWR created a new division, California Energy Resources Scheduling (CERS), that immediately began purchasing power. During the summer of 2001 alone, CERS purchased 17,000 megawatts of electricity, enough power to supply about 17 million homes and businesses. By the end of 2001, CERS had spent nearly \$11 billion to keep the power flowing in California.

## **Long-Term Power Contracts**

To reduce its daily exposure to the volatile spot energy market, CERS entered into various long-term contracts to lock in more stable, predictable prices.

Several contracts provided a guaranteed revenue source needed to finance more than 5,000 megawatts of power from new power plants. In total, the Department entered into 58 long-term agreements in 2001 and 2002 with projected cost of \$42.5 billion over the life of the contracts.

# CERS History – Continued

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## Power Markets Stabilize - Reliability Restored

The average spot market price of electricity fell from \$355 per megawatt hour in January 2001 to \$72 a megawatt hour just five months later. There were no power interruptions in the summers of 2001 or 2002.

CERS concluded its daily power purchases operation on December 31, 2002, successfully returning that responsibility to the IOUs who were able to improve their credit standing during DWR's nearly two years as California's principal power buyer.

## CERS Today

The utilities currently act as CERS' agent in managing and dispatching the energy associated with the remaining contracts. Absent full assignment of the contracts to the utilities, CERS fulfills its financial and legal responsibilities for the contracts by auditing the utilities' performance to ensure accurate billing and supplier compliance with contract terms, as well as reviewing and approving utility gas supply plans and financial hedging for those contracts with gas tolling arrangements.

CERS also services \$9.5 billion in bonds. Initial bond proceeds of \$11.3 billion in 2002 were used to repay \$6.5 billion to the General Fund, retire a \$3.4 billion short-term loan, and provide for reserves as required by the bond indenture.

CERS produces an annual Revenue Requirement – filed with the California Public Utilities Commission (CPUC) – that specifies the contract and bond-related expenses that must be recovered from the utility customers, and actively monitors and reports on its revenue flows and operating balances in compliance with its financial duties related to the bonds.

# Long-Term Contracts Summary

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- Number of Original agreements: **58**
- Original portfolio projected cost: **\$42.5 billion**
- Agreements Renegotiated: **35**
- Number of original counter-parties: **30** – Allegheny, Alliance Colton, BPA, CalPeak, Calpine, Capitol, Clearwood, Constellation, High Desert, Coral, Dynegy, El Paso, GWF, Intercom, Kings River, PG&E Energy Trading, PacifiCorp, Pinnacle West, Mirant, Morgan Stanley, Primary Power (Imperial Valley), PX Block Forward, San Francisco, Santa Cruz, Sempra, Soledad, Sunrise, Whitewater Energy, Williams, Wellhead.
- Number of counter-parties with renegotiated contracts: **19** -- Calpine, High Desert, Constellation, Whitewater Energy, Capitol Power, CalPeak, GWF, Colton Power, Mountain View Power Partners (formerly PG&E Trading contract), Williams, Clearwood, Wellhead, County of Santa Cruz, Sunrise Power, Goldman Sachs (formerly Allegheny contract), Soledad, El Paso, Morgan Stanley, Mirant.
- Cost reductions through renegotiations: **Approximately \$7.5 billion**
- Agreements expired: **28**
- Agreements terminated: **4**
- Number of agreements remaining (from original 58): **26**
- Current projected portfolio cost (2008-2015): **\$14.9 billion**

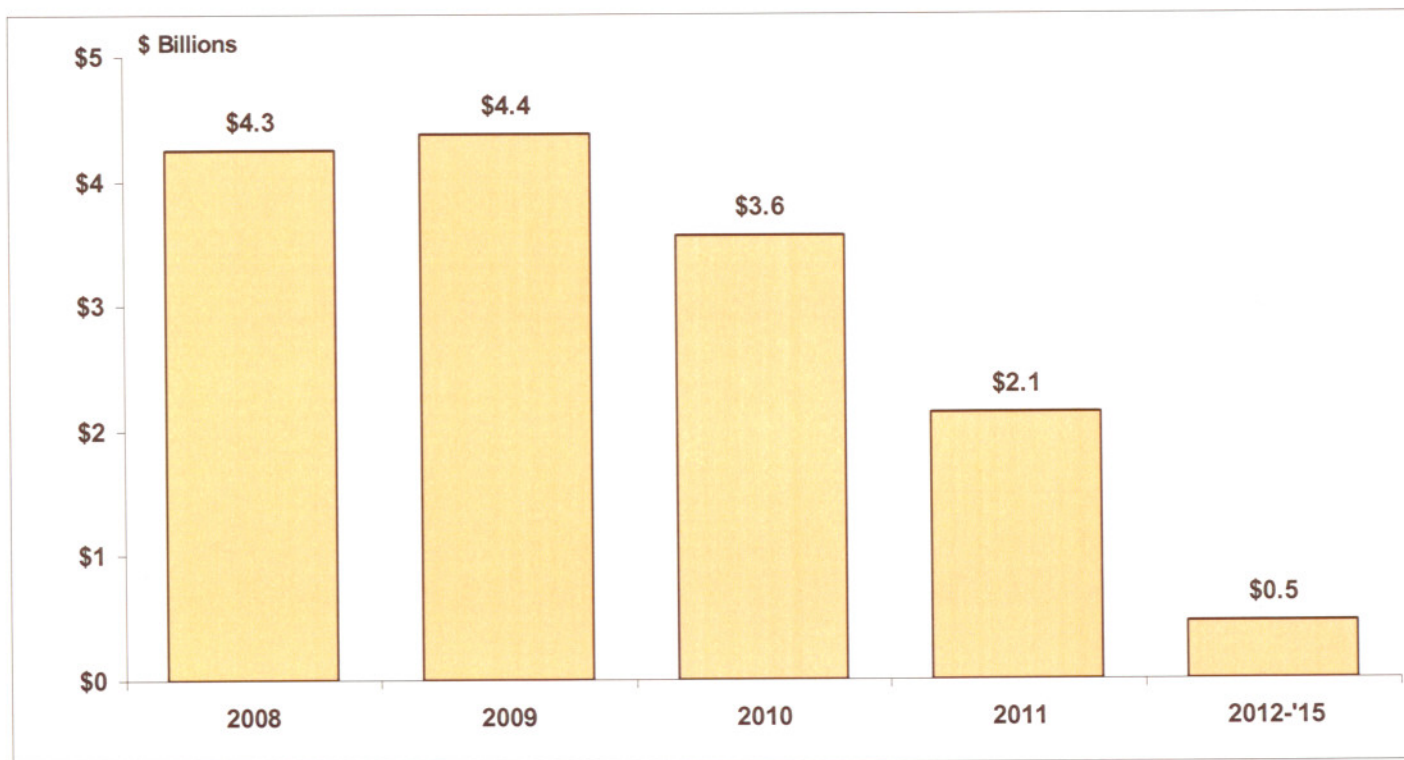
CERS long-term contracts are available at [www.cers.water.ca.gov](http://www.cers.water.ca.gov).



## Long-Term Contracts Summary – Continued

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The remaining cost for the portfolio of contracts, from 2008 through 2015, is approximately \$14.9 billion dollars.

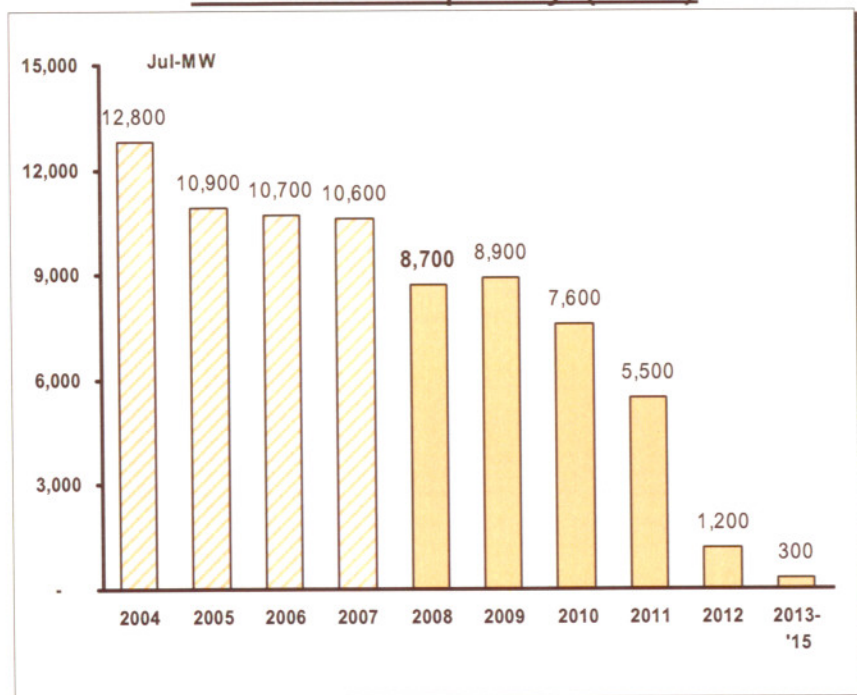


Note: Annual projections are from CDWR July 08' PROMOD Run 13 and may vary due to updates to gas price forecasts, contract utilization, and other assumptions.

# Long-Term Contracts Summary – Continued

The long-term contracts portfolio peaked in 2004 at 12,800 megawatts, remained above 10,000 megawatts through 2007, and substantially ends by 2012.

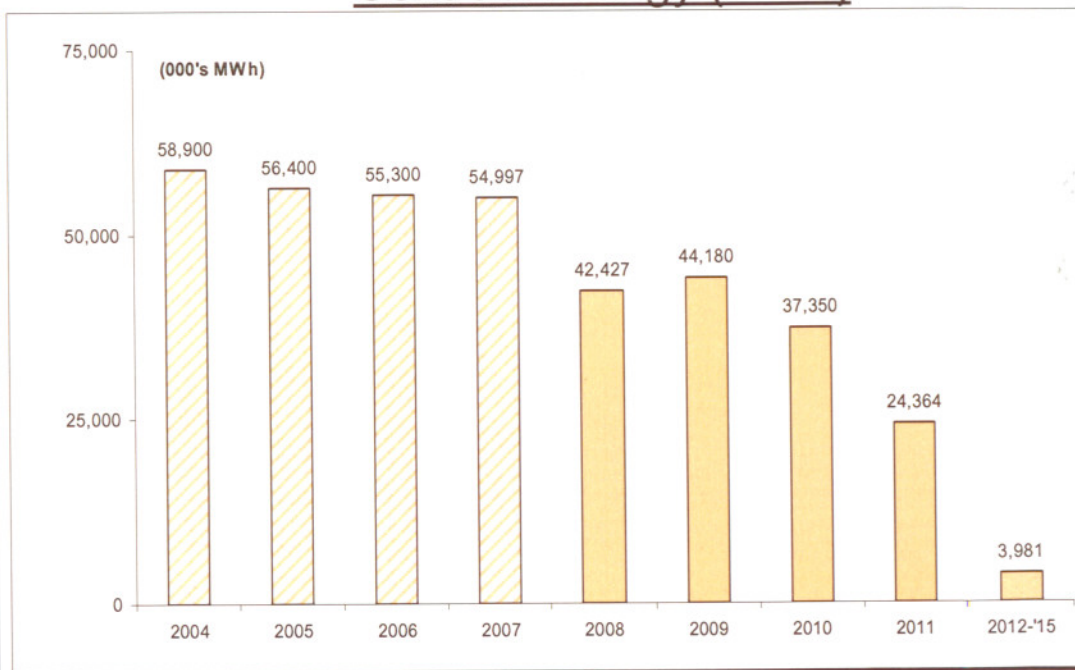
## Contract Capacity (MW)



### Notes:

Includes all renegotiated contracts to-date. Contract Energy Projections are CERS July 08' PROMOD Run 13

## Contract Energy (MWh)



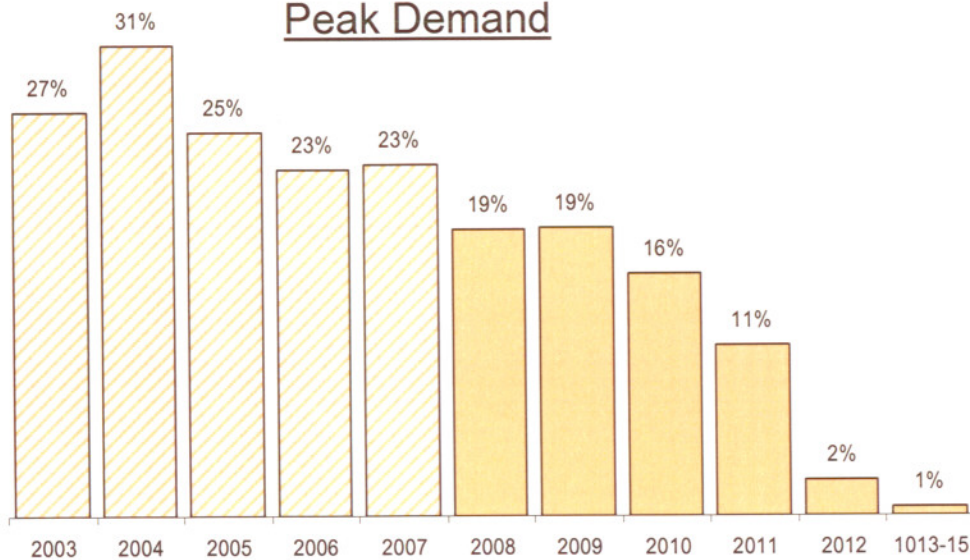
	% of Annual Energy								
	'04	'05	'06	'07	'08	'09	'10	'11	'12-'15
Must-Take	87%	81%	82%	83%	80%	77%	73%	78%	31%
Dispatchable	12%	18%	17%	17%	19%	22%	26%	20%	55%
Renewable	1%	1%	1%	1%	1%	1%	1%	2%	14%

(%s may not add to 100% due to rounding)

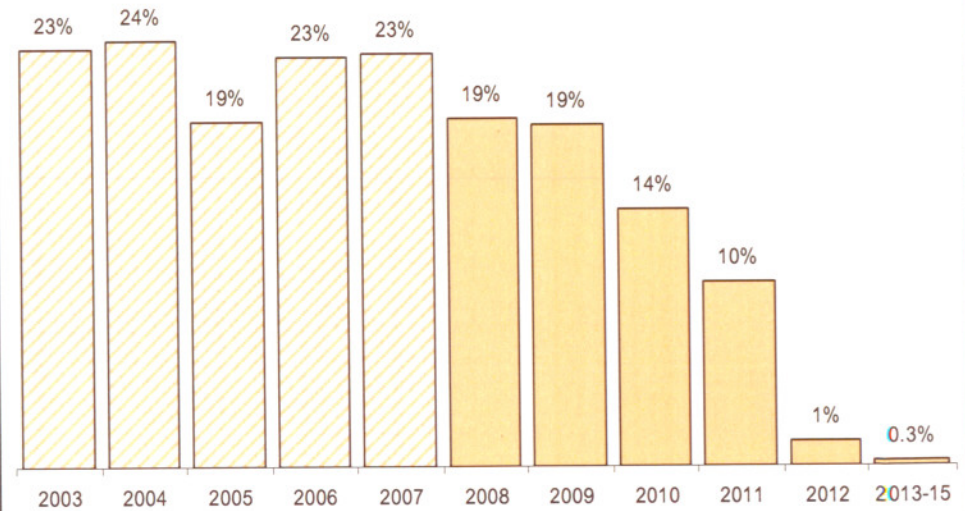
# Long-Term Contracts Summary – Continued

CERS contracts will continue to serve a significant percentage of the three utilities' peak demand and energy requirements until 2012.

Peak Demand



Annual Energy



Note: Historical percentages (2003-2007) are approximate and are based on a CERS analysis of publicly available information from the IOUs. Projected percentages are based upon CERS February 15, 2008 Supplemental Revenue Requirement filing at the CPUC and current California Energy Commission projections of IOU load requirements.



# Revenue Requirement

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Pursuant to Sections 80110 and 80134 of the California Water Code and the March 8, 2002 Rate Agreement between DWR and CPUC, CERS notifies CPUC of its projected costs for the upcoming calendar year by submitting a Revenue Requirement.

The Revenue Requirement includes projected costs for energy and administration of the contracts for the upcoming calendar year. The cost projections take into account the amount of energy from the contracts expected to be dispatched to customers, the cost of natural gas, sales of surplus energy, and refunds from litigation settlements. The costs outlined in the Revenue Requirement are recovered by CERS from payments made by IOU customers to the IOUs as agent for CERS.

The Revenue Requirement determination is produced at least once per year, typically between the months of June and September. Following a public comment period, CERS formally files the final determination with the CPUC. The CPUC, through a public comment process, then establishes power charges and bond charges sufficient to meet DWR's revenue requirement pursuant to the rate agreement.

Because the cost forecasts may change, CERS may submit a "Supplemental" Revenue Requirement to capture the effect of cost changes, resulting in revised charges.

## Power and Related Costs:

- Costs associated with power supply to be delivered under the CERS' contracts
- Administrative and general expenses
- Extraordinary costs
- Operating reserves

## Power Charge Revenues:

- Revenues from other power sales
- Interest earnings
- Power Charge revenues (including both Power Charge revenues and Direct Access Power Charge revenues, as defined in the Bond Indenture)

## Bond Related Costs:

- Debt service on the bonds
- Changes to Bond Charge Account balances

## Bond Charge Revenues:

- Interest earned on Bond Charge Account balances
- Bond Charge Revenues



# Revenue Requirement – Continued

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## 2008 Revenue Requirement

- CERS finalized its 2008 Revenue Requirement and submitted it to the CPUC for implementation on October 31, 2007. Overall, the power charge was \$400 million less than in 2007 due to lower natural gas prices. CERS total revenue requirement for 2008 was \$3.792 billion for power charges and \$831 million for bond charges.
- CERS submitted a supplemental revenue requirement to the CPUC on February 15, 2008. The power charge in the Supplemental Revenue Requirement was approximately \$630 million less than that submitted to the CPUC on October 31, 2007. The reduction in DWR's Power Charge was due to three reasons.
  - CERS amended and restructured the Calpine 2 contract resulting in a net reduction of DWR's energy costs for 2008 of \$467 million.
  - CERS had \$89 million more in reserves at January 1, 2008 than originally forecast.
  - CERS forecast a need for \$74 million less in reserves at December 31, 2008 than originally forecast.
- The CPUC ordered the implementation of the 2008 Supplemental Revenue Requirement on April 24, 2008.

## 2009 Revenue Requirement

- CERS 2009 Preliminary Revenue Requirement was released for public review and comment subsequent to June 30, 2008. The final revenue requirement is expected to be filed with the CPUC in early August, such that new rates will be established by the CPUC to be effective on January 1, 2009.
- The 2009 Revenue Requirement is expected to be approximately \$1 billion higher than the 2008 Revenue Requirement. Nearly half of the increase is attributable to significantly higher natural gas prices. The remaining increase is attributable to the fact that CERS needs to maintain December 2009 reserve levels near the same level as required on December 2008. In 2008 CERS was able to substantially reduce reserves (and still comply with bond indenture requirements) and use those funds for the payment of costs.

# Refunds from Litigation Settlements

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The State and the IOUs are still seeking refunds on short-term electricity purchases CERS made during the energy crisis on behalf of the IOUs. There are two categories of claims, one from Federal Energy Regulatory Commission (FERC) jurisdictional entities (power marketer, investor-owned utilities) and the other from non-FERC jurisdictional entities (municipal utilities and other governmental entities). The three IOUs are also seeking refunds on their short-term electricity purchases during the summer 2000 period up to January 2001 when CERS began purchasing electricity on their behalf.

## Refund Claims (against FERC Jurisdictional Entities) at 100% of Face Value (in millions)

CERS	\$1,574
All California Parties (including CERS)	\$2,785

## Refund Claims (against Municipal and Non-Jurisdictional Entities) at 100% of Face Value (in millions)

CERS	\$703
All California Parties (including CERS)	\$1,325

As of June 30, 2008 CERS had received \$874.3 million in refunds on short-term electricity purchases during the energy crisis. In addition, \$52.5 million of potential refunds is being held in escrow awaiting resolution of other pending claims against the energy suppliers.

The refunds are used reduce Power Charges to IOU customers and are applied to the cost of the electricity CERS is currently purchasing under its energy contracts.

# Bond Refunding Activities

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In 2005, CERS refunded \$2.594 billion of the original 2002 Revenue Bonds and issued variable rate 2005 Series F and G bonds to lower interest costs.

In March 2008, because of credit rating downgrades to bond insurers as a result of the subprime loan crisis, CERS began to refund certain insured variable rate debt to reduce risk exposure and lower interest costs. CERS had \$1.825 billion of bonds that were insured by bond insurers whose credit rating had been lowered to below AAA. On March 20, 2008, DWR issued \$1.007 par value billion fixed rate Series H bonds to refund \$1.05 billion of outstanding Series C, D and G variable rate bonds in an initial transaction.

Subsequent to March 31, 2008, DWR refunded the remaining \$775 million insured variable rate bonds to eliminate the remaining risk.



# Power Revenue Bonds

## June 30, 2008

(in millions)

Series	Initial Principal Amount	June 30, 2008 Outstanding Principal Amount	Interest Rate Mode
Initial Issues			
Series 2002A	\$ 6,314	\$ 2,826	Fixed
Series 2002B	1,000	1,000	Variable
Series 2002C	2,750	2,333	Variable
Series 2002D	500		
Series 2002E (Taxable)	700		
Total	<u>\$ 11,264</u>		
Refunding Issues			
Series 2005F	\$ 759	\$ 759	Variable
Series 2005G	1,835	841	Variable
Series 2008H	1,007	1,007	Fixed
Series 2008I	150	150	Variable
Series 2008J	130	330	Variable
Series 2008K	279	279	Fixed
Total	<u>\$ 4,160</u>		
Total Bonds Outstanding		<u>\$ 9,525</u>	



# Cash Balances

March 31, 2008

(in millions)

## Power Accounts

Operating and Priority Contract Accounts	\$	1,290
Operating Reserve Account		548
Total Power Account Balances	\$	<u>1,838</u>

## Bond Accounts

Bond Charge Collection Account	\$	326
Bond Charge Payment Account		687
Debt Service Reserve Account		917
Total Bond Account Balances	\$	<u>1,930</u>

**Note:** All cash balances met the requirements of the Bond Indenture at quarter end and for each day during the quarter.

# Revenues from IOU Ratepayers

## Quarter Ended March 31, 2008

(in millions)

	Pacific Gas & Electric	San Diego Gas & Electric	Southern California Edison	Total
<u>Power Charges</u>				
Quarter Ended March 31, 2008	\$ 299	\$ 135	\$ 490	\$ 924
<u>Bond Charges</u>				
Quarter Ended March 31, 2008	\$ 94	\$ 22	\$ 95	\$ 211

# DWR Contract Expenditures for the Benefit of Ratepayers

Quarter Ended March 31, 2008 (in millions)

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<u>Utility</u>	<u>Total Power Costs</u>	<u>Total MWh</u>	<u>Total Gas Costs</u>	<u>Total MMBtu</u>
Pacific Gas & Electric	\$ 342	4.38	\$ 5	1.44
Southern California Edison	309	6.92	242	33.19
San Diego Gas & Electric	64	1.68	54	8.61
<b>Total</b>	<b>\$ 715</b>	<b>12.98</b>	<b>\$ 301</b>	<b>43.24</b>

# Appropriated Costs

## Fiscal Year Ending June 30, 2008

(in millions)

	Annual Budget for Fiscal Year Ended June 30, 2008	Pro rated Budget for Nine months Ended March 31, 2008	Actual Expenditures through March 31, 2008
Salaries, Benefits and Distributed Administrative Costs	\$8.4	\$6.3	\$5.2
Consulting Companies and Personal Service Consultants	7.2	5.4	5.1
Other Operating Expenses and Equipment	1.0	0.8	0.1
Subtotal	16.6	12.5	10.4
Allocation of State Wide Pro-Rata Costs	5.9	4.4	4.4
<b>TOTAL ADMINISTRATIVE COSTS</b>	<b>\$22.5</b>	<b>\$16.9</b>	<b>\$14.8</b>